

ALAN **TONELSON** is a Research Fellow at the U.S. Business & Industrial Council Educational Foundation, a Washington research organization studying U.S. economic, technology, and national security policy. •

His articles on American politics, foreign policy, and international economic policy have appeared in numerous publications, including *The Atlantic*, *Foreign Affairs*, *The New York Times*, *The Washington Post*, *The Wall Street Journal*, *The Washington Times*, *The New Republic*, *Foreign Policy*, *The Harvard Business Review*, *The Los Angeles Times*, and *The National Interest*, as well as in several anthologies. In addition, Tonelson has appeared on many radio and television networks and programs, including *The Newshour with Jim Lehrer*, *The Diane Rehm Show*, *The Nightly Business Report*, *CNN*, *Money Radio*, *TalkAmerica*, and the *United Broadcasting System*. He is co-editor of *Powernomics: Economics and Strategy after the Cold War* (Economic Strategy Institute and Madison Books), and author of *Made in China? America's Failed Trade Policies towards the People's Republic* and *Giving America the Business.. The Business Roundtable's Shoddy Case for Corporate-Driven Trade Policies*, both published by the USBIC Educational Foundation.

The author of a forthcoming book on globalization and the U.S. economy, Tonelson has testified on trade policy before the Senate Commerce Committee. And he has lectured at the State Department's Foreign Service Institute, The National Defense University, the Woodrow Wilson Center, Harvard University, The University of Virginia, the Nitze School of Advanced International Studies, The College of William & Mary, the University of Southern California, the University of California at Los Angeles, the University of California at San Diego, the University of San Francisco, the University of Oregon, the Monterey Institute of International Studies, the David Sarnoff Research Center, The American University, the Philadelphia and Kansas City World Affairs Councils, the Universities of East Anglia, Sussex, and Kent, the University of Bonn, and many other fora.

His previous positions include Fellow at the Economic Strategy Institute and Associate Editor of *Foreign Policy*. Tonelson received a B.A. in history with highest honors from Princeton University in 1975. A native of New York City, he currently resides in Washington, D.C.

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Issue 284

## Pro & Con: The Real Trade-deficit Debate

by Alan Tonelson

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Comments: 27 posts

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Before the current third-world financial crisis, worrying about the effects of **large**, chronic U.S. trade deficits was generally limited to maverick trade-policy critics in and out of government -- and most of the American people. No longer.

Today, even the most respected political leaders and experts are sounding nervous about the gap between America's exports and imports of goods and services, which hit a record \$164.3 billion in 1998 and will probably exceed \$200 billion this year. "What, me worry?" treatments of the deficits are increasingly confined to libertarian extremists (fearful that anti-deficit policies will mean more Big Government) and corporate propagandists (determined to hide the extent to which U.S. multinational businesses today are exporting good jobs, not goods and services).

For example, then-Treasury Secretary Robert **Rubin** warned his foreign counterparts earlier this year that "the international system cannot sustain indefinitely the large current account imbalances created by the disparities in growth or openness between the U.S. and its major trading partners." Federal Reserve Chairman Alan Greenspan played down the likely near-term costs, but has called the recent surge in the deficit "disturbing."

As these leaders see it, the deficits show that Americans are consuming much more than they are producing. If the national debt burden gets too high, foreign lenders may start to doubt the nation's ability to repay. A halting or slowing in their lending -- much less a withdrawal of capital -- would deny the fuel needed for American growth, and make debt repayment even more onerous. Alternatively, Washington could raise interest rates high enough to re-attract foreign lenders, but also high enough to depress economic activity at home. Continuing, inexorably mounting debt repayment ("the miracle of compound interest" in reverse) would slow growth even further.

**What does the deficit mean? What should be done to fix it?**

**Today**, the serious trade-deficit debate focuses on two related disagreements. First, do the deficits result largely from problems that governments allegedly cannot or even should not do much about? Examples of these are inadequate U.S. savings rates (which lead to

Americans' overconsumption), or disparities in business cycles around the world, which means that the fast-growing U.S. economy has been absorbing much of the output that its slow-growing partners cannot. Or, as others argue, are the deficits caused mainly by U.S. openness to imports and foreign barriers to U.S. exports?

Second, should America's response therefore focus on boosting domestic savings or jumpstarting growth abroad as much as possible? Or should Washington use the threat or reality of new U.S. restrictions to knock down those abroad and actively help its domestic companies and workers?

The Greenspan-Rubin crowd continues harping on the savings shortfall -- thereby in effect endorsing the status quo. Yet more and more evidence reveals that the status quo is increasingly unacceptable, and that foreign protectionism is a prime culprit.

For example, the deficit is heavily concentrated in manufactures, which create the economy's best-paying, most productive jobs on average. Persistently high import penetration and inadequate exports in industries whose efficiency and innovativeness should be generating much more global market share has helped dramatically shrink their payrolls and left low-paying, relatively unproductive service sectors as the economy's premier job creators. (See Tonelson's "The Myth of High-wage Service Jobs," June 17, 1999)

Further, America's trade balance in many of the vaunted "industries of the future" has deteriorated sharply even as economic cheerleaders proclaim America's global technological supremacy. Leaving out aerospace -- which faces limited global competition and has enjoyed extensive subsidies -- the U.S. high-tech trade deficit grew from \$3.7 billion in 1992 to \$14.9 billion in 1997. Venerable economic theories like comparative advantage tell us that what a country trades most successfully is what it winds up producing. U.S. global technology and manufacturing leadership is incompatible with growing deficits in these sectors. Indeed, it stands to reason that companies in deficit industries will hesitate to invest in U.S.-based factories or upgrade their existing facilities if U.S.-based production can be disadvantaged and even crippled by unrestrained foreign mercantilism.

#### How to correct the deficit

The major responsibility of trade barriers for these deficits also is getting harder and harder to dispute. Economic research has firmly established that, since the end of World War II and regardless of relative growth rates, Americans have a heartier appetite for foreign products than vice versa. Either our miracle economy is still creating shoddy goods, foreigners are culturally or genetically averse to American products, or trade barriers do significantly affect trade flows.

Finally, emerging U.S. trade patterns show the strong connection between cavalier U.S. trade policies and the global concerns expressed by Greenspan, Rubin et al. Low-income countries used by multinational corporations to manufacture advanced products account for rapidly growing shares of U.S. trade flows and deficits.

These deficits stem largely from U.S. trade policies like NAFTA and continuing normal trade with China (which have encouraged such outsourcing); from Washington's failure to press Japan and Western Europe to buy proportionate shares of third-world output; from IMF and World Bank advice to these countries to grow mainly by exporting; and from the nature of **export-oriented** manufacturing in the developing world, which depends heavily on keeping wages (and therefore national consumption levels) down.

The profitability of exporting from these countries helped them to attract the huge amounts of pre-crisis capital that are now widely seen as excessive. But of course not all countries can grow mainly by exporting at the same time. And when jockeying for the U.S. market intensified with China's currency devaluation in 1994, the Asian exporters who began to get squeezed out became vulnerable to a series of economic shocks, like unfavorable currency movements, relatively high U.S. interest rates, and cyclical downturns in key areas like electronics. Large-scale capital flight and ultimately crisis soon followed.

In other words, if Greenspan, former Fed Chairman Paul Volcker, and many others are right, and the world economy has become more crisis-prone because of "hot money" flows to developing countries, the wide trade imbalances fostered and tolerated by U.S. trade policies bear much of the blame. Thankfully, these leaders now acknowledge the growing dangers of these deficits. But future American prosperity will depend greatly on their willingness to recognize the causes, accept the logical consequences, and address the deficits directly.

*Alan Tone/son is a research fellow at the U.S. Business and Industry Council Educational Foundation.*

**3.9%**  
Intro  
APR

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Is there a turn of the tide in the deficit debate? Why don't other countries want U.S. goods? How do you suggest America should change its trade policy?

Below are the last ten comments in chronological order.  
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8/28/99 6:52:29 PM OC

Ron W. - You say Fewer will produce our needs and the rest of us can "Do **some**thin else." Like what? When Fewer produce that promotes a widening of the gap between the haves and the have-nots because only the Few will have money. Not everyone can become a brain surgeon or physicist. Not everyone, due to circumstances out of their control, can get educated for a professional position. Try and get waited on in department stores; try talking to a breathing body when you call the phone company. These jobs have been erased and thus Fewer of us are productively employed. There are similar situations in other industries.

8/28/99 10:30:23 PM Allen Phelps

OC: Ron W was showing a correlation **between** the way manufacturing is tending and what agriculture has gone through. Go back a couple hundred years and probably 80-90 percent of the workforce was engaged in agriculture. Today only about 1-2% work in agriculture. We don't produce less than we did then (we actually produce far more). That does not mean the farmers own all the wealth, other sectors of the economy opened up. For a time, manufacturing. It also grew to take most of the work force and is now starting to taper off in terms of people employed. It still produces more than ever, just with fewer people.

8/29/99 6:24:18 PM Bill Langeman alphacatbill@netscape.net

The simple ignorance about economic issues never ceases to amaze me. In the first place, most economists **will** tell you that the U.S., may in fact have a trade surplus. What so many don't understand is that the deficit is as reported by the Feds. However, it is generally known that imports are accounted for much more completely than exports by the methodology currently used. Two examples: foreign students studying in the U.S., are not included as exports nor are profits earned by U.S. multinationals via there foreign operations (a Coke plant in Belgium for example). In addition, we have financed much of our economic expansion with foreign capital (the Japanese **buying** Treasury bonds would be an example). As for the **spectre** of cheap foriegn labor gobelling up jobs... one can remember the Japanese juggernaut as trumpeted by the popular press in the 80's. The low wage jobs are gone, as the would and should be. Go riddance. Who in their right mind believes slow skill, low wage jobs are the path to greater human dignity and creativity in the U.S.. The fact is, "comparative advantage" assures that high vaslue added employment will be located in the U.S. as low value added jobs will migrate to third world countries. This situation is for the highest and best good of all concerned.

8/29/99 7:30:08 PM Mean Mark

Well stated, Bill Langeman.

8/29/99 8:17:41 PM

Mean Mark, if you are going to be so outgoing and complimentary, you might think about changing your tag to "Pleasant Mark"

8/29/99 8:31:43 PM Mean Mark

Anon: Thanks, but His Meanness enjoys the title Mean Mark better...My "mean" moments are reserved for the likes of Herr Paul Rosenberg of the Liberal Gestapo and his Minister of Racial Disharmony El Azul the fool...

8/29/99 11:44:39 PM Mark Amerman mandrewa@cais.com

Bill Langeman: This 1998 current account table at <http://www.intellectualcapital.com/issues/issue284/item6182.asp> has items for "income from abroad" of 258 billion and "income paid out to foreigners" of 270 billion. Are you saying that profits from a Coke plant in Belgium are not included in "income from abroad"? Are you saying that money flowing into the country to pay for foreign

student tuition is not included in any of the items on this current account table? Or are you simply saying that these things are not included in the trade account, which is one of the sub-components of the table? Please understand that this is not a rhetorical question as I am still struggling with all of this. More generally which components of our current account data are most likely to be erroneous? And-in what direction? Can you refer me to an analysis of the likely errors? Notice the fudge factor: "statistical discrepancy **11** billion." It is pretty obvious that the economists making this table knew that their data was incomplete, but on what basis could they estimate the magnitude of the error?

8130199 3:26:32 PM

I would venture to guess that Mean Mark is registered as a member of Dogbert's New Ruling Class... Wonder what your title is?

8/30/99 5:08:39 PM Mean Mark

Anon: This could prove helpful--"To: Dogbert's New Ruling Class (DNRC)From: Scott AdamsDate: March 1995DNRC Status ReportIn just eleven months Dogbert's New Ruling Class has grown to over 20,000 cynical (yet oddly attractive) members! But don't worry, that still leaves well over 5 billion people to do our menial work after Dogbert conquers the planet and enslaves all non-members. Start putting your job list together now. Name the Non-DNRC PeopleWhat we really need is a good derogatory nickname for non-DNRC people. The phrase "non-DNRC people" is kinda klunky and doesn't convey our full contempt for fact that they squander our valuable resources such as oxygen and vowels. Their name should sound harmless and endearing but have a clever double meaning. For example, we could call them "pumpkin" to their faces, then mutter "...head" under our breath while clearing our throats. Or we could call them "Dumplings", because you can't say dumpling without "duh." I'll print the best suggestion in the next newsletter. And the person who suggests the winning name will be elevated to DNRC Sainthood. (Note: My examples were intentionally non-funny so as not to discourage your participation by overwhelming you with my own professional suggestions. I could do much better. I'm just holding back. I'm not defensive. Leave me alone. Stop touching me.)" -- Scott Adams

8131199 6:50:40 PM Albert

... but many foreign students do not pay their own tuition.It is paid for them by the U.S. university, or even by the U.S. government. I can't imagine that foreign students account for very much one way or the other in the national income accounts, but the impression given, did not tell the whole story.

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